

MINUTES
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Monday, July 18, 2005, at 9:00 a.m.
State Capitol Building, Room 303

PRESENT: Superintendent of Public Instruction Linda McCulloch, Secretary of State Brad Johnson, and State Auditor John Morrison

VIA TELEPHONE: Governor Brian Schweitzer

ABSENT: Attorney General Mike McGrath

Motion was made by Mr. Morrison to approve the minutes from the regularly scheduled meeting of the Board of Land Commissioners held June 20, 2005. Seconded by Mr. Johnson. Motion carried unanimously.

BUSINESS TO BE CONSIDERED

705-1 TRANSFER OF PARCEL – CITY OF BOULDER

Ms. Sexton said this is the third in a number of transfers we've had with the Department of Corrections. Property has already been transferred for use as a football field and for storage for the road department. This request is for final approval of a transfer for use by the City of Boulder for a wastewater lagoon and pipeline.

Harold Stepper, Jefferson County Planner, said we have had four land transfers with the fairgrounds as well as those previously stated by Director Sexton. We are hoping the City of Boulder can finalize this transfer. It has gone through minor subdivision review, and has final plat approval. The reason we had to go through subdivision review is because we could not do a boundary relocation as we could with the others. With that, I would request approval.

Motion was made by Mr. Johnson to approve the transfer. Seconded by Mr. Morrison. Motion carried unanimously.

705-2 REDUCTION OF MINIMUM BID FOR DPHHS PROPERTY

Ms. Sexton said this is a request for a reduction of the minimum bid for Department of Public Health and Human Services' property in Miles City. Originally, this went to public auction with the appraised value of \$17,500.00. There were some bidders who didn't reach the minimum bid and the concern expressed was that there was no sewer and water hook up. The building itself was in very poor condition. It was suggested that this be reduced to a value of \$9,000.00. Because of the roof repair and the cost to hook up services, DPHHS proposed the minimum bid be \$9,000. DNRC concurs.

Mr. Johnson said I assume the original appraisal was carried out by DPHHS and not DNRC?

Jeanne Holmgren, Real Estate Management Bureau Chief, said we went back to the appraiser who reconsidered the \$17,500 and did a reappraisal because of the diminished condition of the building and the fact that it had a long way to go to be hooked up to the city water and sewer. The well on the property

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has failed and they needed to replace and hook up to the septic. It was done through an appraisal contracted by the DPHHS.

Mr. Johnson said it concerned him that the original appraisal was so far off from the ultimate price settled on. He said he wanted to make sure we were more cautious when doing appraisals on other property.

Motion was made by Mr. Johnson to approve the reduction of minimum bid for the property owned by DPHHS in Miles City. Seconded by Mr. Morrison. Motion carried unanimously.

705-3 APPROVAL OF COMMUNITIZATION AGREEMENT
(Fidelity Exploration & Production Company)

Ms. Sexton said this is a request for approval of a communitization agreement located in Big Horn County. Fidelity Exploration and Production Company has filed to communitize state-owned acreage. The acreage within the tract is about 37%, or 59 acres. The department recommends approval.

Motion was made by Mr. Morrison to approve the communitization agreement request. Seconded by Mr. Johnson. Motion carried unanimously.

705-4 CHERRY RIDGE UNIT AGREEMENT

Ms. Sexton said this agreement is not quite as typical as the communitization agreement. This is a request from L. E. Behm of Minot, ND, who anticipates discovering commercial gas from the Eagle formation located about 25 miles north of Chinook. A unit agreement allows an oil and gas reservoir to be developed and operated by a single entity. The proposed unit would be a Federal Exploratory Unit in that it utilizes the standard Federal Form Unit Agreement. It would be regulated by the Bureau of Land Management and allows the BLM leases to be extended. The applicant is proposing unitization of approximately 44,769.93 acres located along the Montana-Canadian border. The state owns 1,920 acres within the proposed unit boundary. It does not change the terms of our leases, they are still 10-year leases, it just allows a single entity to operate.

Motion was made by Mr. Johnson to approve the unit agreement request. Seconded by Mr. Morrison. Motion carried unanimously.

705-5 APPROVAL OF METALLIFEROUS LEASE APPLICATION

Ms. Sexton said this application is from James Ployhar of Great Falls, Montana, for about 92 acres in Fergus County. This is under the new rate whereby the initial rental rate will be \$3.00/acre for the first year and then down to \$1.00/acre for the second and third year, then at \$2.50 for the fourth and fifth years, and at \$3.00/acre thereafter. The royalty rate will be 5%. DEQ has requested and received the bond. This is in an area of old material and the applicant will be looking for gold. There is discussion about raising the rates and that could be done through rulemaking so it doesn't have to go down to the \$1.00/acre rate. The department requests approval.

Ms. McCulloch asked if there were any special stipulations on this application?

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Ms. Sexton said no.

Mr. Morrison said what is the bonding? The lease he has says the bond is waived.

Ms. Sexton said that is because DEQ requested and received the bond.

Monte Mason, Minerals Management Bureau Chief, said the bond is \$800. It is a very small proposed operation. DEQ reviews the operation and will adjust the bond accordingly if they submit any revisions. Because it is fully bonded by DEQ we have waived having a duplicate bond associated with our lease.

Motion was made by Mr. Morrison to approve the application for a metalliferous lease. Seconded by Mr. Johnson. Motion carried unanimously.

705-6 REQUEST FOR APPROVAL OF SALE OF LAND BANKING PARCEL
Sale # 202

Ms. Sexton said this is a request to sell the parcel that was postponed from last month's meeting. It is an 80-acre parcel in Flathead County. The acreage has not been homesteaded, there is access through Forest Service land but the state does not have legal access. There are potential access options, either through private property or from the Forest Service through a cost share agreement. A reciprocal access has been initiated across this tract to adjacent to Plum Creek land, across the northwest corner. Plum Creek could access across this tract to their land and the state would acquire access across Plum Creek land to a proposed timber sale. The DNRC appraisers estimate the value of this tract, with access, at \$2,000 per acre. The return rate on this parcel has been very low, timber has not been cut for a number of years and there is very little timber on it. The assessment of potential buyers include those interested in recreational property and perhaps the adjacent landowners. There are two building sites on this property. The department requests approval to evaluate this parcel.

Mr. Morrison asked why on 80 acres are there only two building sites? What is the nature of the terrain?

Ms. Sexton replied it is fairly rugged terrain and steep.

Mr. Morrison asked if it was on the slope of Haskill Mountain?

Ms. Holmgren said yes, it is an 80-acre parcel that is isolated. To perfect access and also to log the property it would be of great cost. Management for traditional uses is difficult. Given the surrounding property owners and the configuration, it makes sense that in some point in time it should be developed. There are two likely building sites that are fairly high but are accessible via a road, otherwise it is fairly steep. Adverse-type logging would have to occur. It is probably not conducive to more than just two building sites because of the terrain.

Mr. Morrison said it would be sold as an 80-acre parcel and then whatever subdivision took place would be done by the buyer?

Ms. Holmgren said that is correct, and it would have to go through local regulation.

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Mr. Morrison said do you have any sense for what we might end up getting for it?

Ms. Holmgren said around \$2,000 per acre is what we believe is a reasonable value for selling the property.

Mr. Morrison said it is my understanding after the preliminary approval and following the appraisal, there will be an opportunity for public comment.

Ms. Holmgren said that is correct. But also, throughout the process there is always opportunity for public comment. MEPA has already occurred. Prior to coming for preliminary approval we conduct MEPA. We have done our scoping associated with the formal MEPA process. But public information and comments can always come through. Information will be posted on our website so there will be opportunity for public comment.

Mr. Morrison said so there is already been an opportunity for public comment, and that opportunity for comment will continue?

Ms. Holmgren said yes.

Motion was made by Mr. Johnson to grant the department approval to evaluate this parcel. Seconded by Mr. Morrison. Motion carried unanimously.

705-7 DNRC/FIVE VALLEYS LAND TRUST LAND EXCHANGE

Ms. Sexton said this is the DNRC/Five Valleys Land Trust land exchange and is part of a larger Alberton Gorge Project. It has been ongoing for 15 years. This is for preliminary review to look at what parcels we may be utilizing to trade out Section 35. Section 35, next to state Section 36, is near Tarkio and that was the piece purchased by the Five Valleys Land Trust because of its unique features and benefits to the public. It does have timber land on it next to state Section 36. From that perspective, it would be reasonable we acquire this to enhance and complement Section 36 and also provide greater public access. There are a number of parcels proposed that we would consider, given the Board's approval, as part of this exchange. These parcels will go to the Five Valleys Land Trust who will depose of them. Five Valleys are floating a substantial note with the bank for Section 35. The parcels suggested that would come to DNRC are not only Tarkio Flat, there are several others, there is Tarkio Railroad, Freezeout Gulch, and the Cyr Bridge. There is a total of 581 acres that would come to the DNRC. From the DNRC to Five Valleys there is 615 acres. This is more than the estimated arranged value of leased parcels that were transferred to Five Valleys and are a greater amount of money than we will probably receive for the appraised value of the properties from them. At this point in time we are asking the Board for approval to go out and review these acreages and get appraisals on them. There are six parcels and the sixth one, Cayuse Creek at 66 acres, does have some public access to the river and it is the most controversial piece. We included it at the request of the Mineral County Commissioners. The Commissioners were a party to the original Gorge Project which involved FWP, BLM, and a number of other entities, and their concern is they are 80% public land. Their public comment is they would like to see more parcels developed to increase their tax base. Public input is certainly an important piece of what we're doing with our exchanges and real estate activities so it was at their request this piece be included. It is up to the Board at this point. We could do further analysis including putting restrictions on this piece, such as retaining public access, or perhaps there are options here for a park if we were to work with non profits and local

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government in the area. I think this parcel will present a lot of opportunities but I just want to point out to you that of the six parcels, this one is the most controversial. The other parcels will probably be developed for potential use. This is just for the Board's initial approval for us to look at these parcels and do appraisals on them. Then the information will come back to the Board with those amounts because it needs to have the same or greater value so the exchange is as close to equal as possible.

Ms. Holmgren said parcels 3 and 4 are indicated to come to the DNRC are small acreages that are an abandoned railroad easement. We were not proactive in buying those easement areas that are attached to state land. Acquiring these parcels provide public access to existing trust land from the river. Otherwise there is no public access to these parcels. We have perfected access for natural resource management purposes only. So getting parcels 3 and 4 gives us that area between our property and the river which provides the only public access to that property. However, it would only be via the river there is no public road access.

Ms. Sexton said I would also add that we would gain miles of navigable river with this proposal. It is required if the state trades or has any exchanges that it not lose navigable river miles. From the initial appraisals, that land is coming from high value to us at about \$1.5 million and if we took all six of these parcels the initial appraisal would be about \$2.3 million. So you can see we will probably not include all of these parcels.

Ms. McCulloch asked with the Cyr Bridge parcel does that give us back the entire Section 36?

Ms. Holmgren said yes.

Mr. Johnson said under the category, "State land bordering on navigable land or public use waterways," I am confused. I read Five Valleys to DNRC 1.67 miles of steep, high bank Clark River front; DNRC to Five Valleys a total of 1.7 miles of waterway and a notation that that could be modified to meet the criteria.

Ms. Sexton said yes that's correct. I believe as we modify this we cannot use navigable river miles.

Ms. Holmgren said you can exchange navigable for navigable. If we keep all six of these the parcel in, 1.7 miles of navigable waterfront would be exchanged for 2.67 miles of navigable waterfront.

Ms. Sexton said but we would not sell all six of them, the appraised value is quite a bit more for property with river front.

Ms. Holmgren said right, we would have to look at these and what the appraisals are, prioritize the parcels as to which parcels we want to dispose of.

Mr. Johnson asked do we know at this point in the process the usability of that river access? There is a notation of 1.67 miles of steep, high bank Clark Fork river front that we would be receiving. What is the nature of the frontage that we'd be giving up?

Ms. Holmgren said as far as the terrain and accessibility to the river, what we are acquiring and what we are disposing of is fairly the same.

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Greg Tollefson, Special Projects Coordinator for the Five Valleys Land Trust, said there are lots of complicated questions regarding this. This is the next phase of the Alberton Gorge Project we are moving ahead with at the behest of the Mineral County Commissioners who had justifiable concerns with the movement of private property along the Alberton Gorge into public ownership. Justifiable because that county is nearly 90% in public ownership. So the loss to their tax base was a serious concern for them. We have moved ahead with this land exchange proposal with DNRC. When finalized, the land that DNRC moves to Five Valleys, which we will then move into private ownership, will not be comprised of all the parcels. We will be mixing and matching and trying to come up with the right values and river front that meets the state's criteria. We urge the Board to give the "go ahead" to move forward with this project.

Ms. McCulloch asked when the department expected this to come back before the Board?

Ms. Holmgren said six months. We have to do MEPA.

Ms. Sexton said this project has been ongoing for 15 years, so at this point time isn't of the essence as much as making sure we have crossed the "t's" and dotted the "i's" and are careful about the selection of properties.

Mr. Johnson said right now we are about \$800,000 in terms of comparable value, is it a realistic expectation that we can close that gap considerably in the process?

Ms. Sexton said yes. As mentioned before some of the parcels we are nominating for review will be ruled out, and we will have prioritization on accessibility and a number of other criteria to determine which are the top priorities. We may come to the Board and ask on which ones it would like the further review done.

Motion was made by Mr. Morrison to grant preliminary approval to the proposed land exchange. Seconded by Mr. Johnson. Motion carried unanimously.

705-8 SET MINIMUM BID FOR LAND BANKING PARCELS

Ms. Sexton said this is the first of many parcels for land banking that the Board will have a second look at. That means that you will have information regarding the appraisals that have been done and any cultural information that has been found. The first, Sale #222 in Madison County, has been temporarily withdrawn. We did the appraisal for this property, 479 acres at \$2,019 per acre, and the neighboring landowners, those who do hold the lease for this property and have nominated it, asked that it be postponed so they can analyze the appraisal. It came in higher than they expected. They would like to postpone it until the next Board meeting. We can go ahead with the second parcel, Sale #340 in Jefferson County. This is not too far out of town, it is for 160 acres near a field with a lot of towers and technical equipment, on a ridge near Interstate 15 and the Ash Grove Cement Company. There is access to this parcel. The appraised value with access is \$3,100 per acre. The minimum bid would be \$496,000.

Ms. McCulloch said for clarification, we are postponing the entire Sale #222?

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Ms. Sexton said yes, and we are only considering Jefferson County, Sale #340, the 160 acres close to Helena.

Mr. Johnson said can you tell me what the revenue history has been on that parcel?

Ms. Sexton said it has been leased for grazing.

Mr. Morrison asked where are we on the total amount of acreage in the sale category in the land banking program right now?

Ms. Sexton said 24,500 acres.

Mr. Morrison asked how is what we're doing today affecting the 20,000-acre limit on sales without purchases?

Ms. Sexton said we can only sell up to 20,000 acres without purchasing other lands. Of course we nominated more with the understanding that not all of the nominated tracts will be sold. When we purchase land we can sell more land.

Mr. Morrison said you can nominate more than 20,000 acres but you can't sell more than 20,000 acres and we are still in the nominating process.

Ms. Sexton said sometimes when the appraisal is completed, the landowners who nominated the parcels that think the appraisal is more than they expected and they aren't in the position to purchase it. They can, pursuant to our land banking rules, withdraw it.

Motion was made by Mr. Morrison to approve the request to sell parcel #340, Jefferson County tract. Seconded by Mr. Johnson. Motion carried unanimously.

705-9 PEIS FOR REAL ESTATE MANAGEMENT BUREAU

Ms. Sexton this has been an ongoing process with public input at several meetings we've held. With that input we've made some changes to the PEIS. Primarily, the public involvement has been put up front before a project goes through the management plan. We will have public input, scoping sessions, and we will involve communities before we even look at parcels for projects. The other area that has been substantially reviewed is we are focusing primarily on urban growth areas where we have the greatest potential for gaining revenue. We are looking at industrial, commercial, and residential development in those areas close to incorporated cities or in areas that have public sewer and water. From the discussion with you over the last week we made some changes. On page 4, under The Scope of the Plan, it was changed to read, "The Plan covers those activities related to the leasing, exchanging, or selling of Trust lands for residential, commercial, industrial, and conservation purposes. Leases, sale and exchanges associated with traditional land management activities, i.e., grazing, agricultural, timber and mineral management, are outside the scope of this plan." On page 7, we also took out the sentence related to going above the 5% cap. We had one more change on page 22, there was an inconsistency in wording. I would note the relationship to general development standards, it is located under Selection Filter. We added the words, "location criteria" and "relationship to general development standards." Those are the changes, it has been refined and reviewed a number of times.

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Ms. McCulloch thanked Director Sexton for coming to her office and going over the document.

Mr. Johnson said he wanted to commend Director Sexton and the department for a job very well done. I think this is going to provide us with a tremendous tool. I have had a number of individuals involved in commercial development come to my office and express serious concerns about trying to work with the state. I think this is going to address some of those questions and concerns.

Ms. Sexton said ultimately the Board makes the decisions. These are standards and guidelines that we will be utilizing in the PEIS as we review and look at projects for residential, commercial, conservation options, and industrial development on state lands. We have further delineated what the conservation options are, including conservation licensing, and our attorney's analysis on how those opportunities can be used.

Anne Hedges, MEIC, said although I haven't seen the latest draft in the last couple of days, I can say this PEIS is what we were looking for many years ago. I think the department has direction, it has focus and has now given the public a better idea of what it intends to do on these lands. I really appreciate the work the department put into this. It took a long time to get it going but once they got going on this they outdid themselves. There are still a lot of questions. We could keep looking at this document for another year and still find changes to make, but the time has come to adopt this and take the next step which is to commence rulemaking. I am a strong advocate for rules. I think they help the public understand what steps agencies go through when they make these important decisions in their communities. The department has come a long way in recognizing the Whitefish example and all of the benefits and problems they encountered and they have incorporated that into this document. The next step is to create rules so you can give them to the public. I went through the long process of creating rules on land banking. It is nice to hear the discussions going on today because a lot of questions asked were questions we spent a lot of time discussing at DNRC. We answered them and they were answered today because of those discussions, because we put that information in rule and they benefited from a lot of parties being able to look at a problem and solve it together. This is in much better shape than the land banking rules were when they first started. I think we can take this document and easily turn it around into a very workable set of rules that the DNRC can hand out to communities and everybody can understand what process DNRC is going to have and how the public will be involved. I'd like to commend the department for taking a hard look at this and emphasizing urban areas and trying to benefit from what we learned in Whitefish.

Kathy Swift, Counsel for the Montana University System, said I am here on behalf of the campus trust land beneficiary. As the beneficiary we support the goals that are stated in the management plan and we also support the diversification of the trust land portfolio. We appreciate the work of DNRC and we urge support for the plan.

Tim Davis, Montana Smart Growth Coalition, said I'd like to thank the department for doing a terrific job of engaging time and time again the public in the process and really listening to the comments and incorporating them. I think they did a terrific job. I do think that rules would help clarify a couple of the outstanding questions. The rulemaking process should be relatively painless because the ROD is so clear. One example of why there needs to be more clarification in the rules is on page 22, Project Selection Criteria. It lays out the criteria but doesn't say how the department will apply them. My comments last time were on the point system other departments use for weighing criteria, and we'd like to see the rules clarify those type of issues but we'd like to see it very clearly use the ROD to guide that rulemaking

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process because DNRC spent so much time with so many different public interest groups in getting out to the public as much as it can. So base the rules on the ROD.

Motion was made by Mr. Morrison to approve the PEIS. Seconded by Mr. Johnson. Motion carried unanimously.

705-10 CORRECTION TO PATENT NO. 369

Ms. Sexton said this is a patent correction for a fee simple title for a two-acre parcel which belongs to the Roman Catholic Bishop of Helena. It was recently discovered that the legal description is in error. The patent description incorrectly identifies the quarter quarter of the parcel sold and the Bishop has requested a corrected patent. The existing document shows the two-acre parcel to be in the NE $\frac{1}{4}$ of the SW $\frac{1}{4}$ and it should be corrected to actually be the SW $\frac{1}{4}$ of the NW $\frac{1}{4}$. The department has researched the record and found the patent in error and it recommends approval of issuance of a corrected patent to the Roman Catholic Bishop.

Motion was made by Mr. Morrison to issue a corrected patent. Seconded by Mr. Johnson. Motion carried unanimously.

705-11 APPROVAL OF RIGHTS-OF-WAY APPLICATIONS

Ms. Sexton said we have a number of rights-of-way applications this month. There is #12804, 12805, 12803, 12800, 12799, 12798, 12797, 12796, and 12795 from Sheridan Electric Coop for overhead telephone distribution lines; #13093, 13092, 13091, 13090, 13089, 13088, and 13087 from Sun River Electric for overhead distribution power lines; # 13513, 13514, 13515, and 13516 from Prairie County for public county roads; #13129, 13130, 13420, 13429, 13430, and 13431 from Fallon County for public county roads; #13545 from Bigfork Water and Sewer District for a 10" community water main line; #13544 from Donald and Alberta Wood for a private access road for normal farming and ranching activities; #13546 from the City of Kalispell for a municipal fire station; #13551 from Daniel and Sheila Richardson for a private access road to a single family residence; #13559 and 13558 from Retamco Operating Inc. for a private access road for timber management practices; #13530 from Peter and Cathy Balasky for a private access road for a single family residence; and #13547 from Louisiana Pacific Corp for a perpetual non-exclusive easement. Ms. Sexton said I'd like to note a couple of them for the Board. We have a request from the City of Kalispell for a fire station, for \$360,000.

Randy Brodehl, Fire Chief, City of Kalispell, said request #13546 is for a fire station to protect the northern portion of the City of Kalispell. Its been about 20 years coming and we are very happy to see it moving ahead. We went to the voters in November for this and received 60% approval and began the process with DNRC in February. We had been looking at a purchase price of about \$293,000 for this property. The initial estimates were \$262,000 and we had an appraisal that went to \$293,000. Last week I called DNRC and asked who we make the check out to, whether it be DNRC or the State of Montana and the following day I got a call back saying the price had been raised to over \$318,000. I would ask the Board to consider going back to the \$293,000. The reason for the change was a minor line adjustment to include a retention pond and for a change in the approach. The value of the property for a fire station doesn't change when you make that kind of line adjustment. I understand the reasoning by the square foot and by DNRC but in fact the council processed this thinking it was looking at \$293,000. We received no

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information back from DNRC until this week from the information we gave them in May. I urge you to consider the change, this it means a tremendous amount to the community of Kalispell.

Ms. Holmgren said usually when we visit with an applicant we give them estimates until we can conduct an appraisal. If there is additional acreage associated with the ability to conduct a specific purpose for the property, there has to be compensation for that acreage whether it is a retention pond, landscaping, or a trail. To get full value from specific acreage or square footage within a particular parcel we are unable to do that. What is unacceptable is a lack of communication and coordination with the fire district and I do apologize.

Ms. Sexton suggested the Board segregate this request from the packet.

Mr. Morrison moved adoption of the rights-of-way applications with the exception of application #13546, City of Kalispell.

Ms. Sexton said there are a number of rights-of-way applications to go through before the vote.

Ms. McCulloch said we will hold the motion.

Ms. Sexton said the other ones I'd like to note are historic applications for Fallon and Prairie Counties. This is from legislation that requires all counties do an inventory of their roads. I know Secretary Johnson was curious about this. They have to inventory their roads. The roads that go through state lands have to be appraised and the counties have to send us their assessments of the road and the appraised value given the land classifications which the roads go through. That legislation extended the deadline for the counties to complete that inventory. We are currently trying to get an idea of what that amount might be, how many miles of road, and what kind of income we might be looking at for those historic rights-of-way. We hope to have that to you by the next meeting. These toady are the first ones, there are several from Fallon and Prairie Counties. This is required by law and, quite frankly, the counties aren't happy with this, they have to do this inventory. Most counties have not completed their inventory or submitted the reports.

The other requests I'd like to note are we have a request this month that was withdrawn last month, the Balasky's request for right-of-way. We added additional lease stipulations to some areas. And one request has been withdrawn, Lease #13547 from Louisiana Pacific, because some of the numbers were incorrect.

Ms. McCulloch said on Lease #13545, the Bigfork Water and Sewer District's application, this is an after-the-fact request. Why are we being asked to approve an easement when the waterline has already been built?

Ms. Holmgren said the Bigfork Water and Sewer District line had been in place for many years and it failed. In 2003 when it failed, they went back to replace it. The DNRC gave them a Land Use License knowing they would have to come through and perfect their easement. They can come under §77-2-351, MCA, and get an easement without compensation because it is a navigable waterway and not considered trust lands, they are sovereign lands. That is the purpose and why it is after-the-fact. It was originally put in many many years ago.

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Mr. Morrison said I don't see that we need to break these up. I think we can consider them collectively. It doesn't seem there is any issue about the Kalispell one or any of them. It is not necessary for us to approve Lease #13546 separately.

Mr. Morrison moved for approval of all of the rights-of-way applications contained in the agenda item. Seconded by Mr. Johnson.

Mr. Johnson said I want to express concerns regarding potential consequences with these historic rights-of-way for existing county roads. I have had a number of County Commissioners express concern about the fiscal impact of this and in fact suggest an alternative may be to abandon the roads. Which means the state would lose established and maintained access to state lands. I want to make sure we're not getting into something where we're not fully aware of the consequences.

Mr. Schultz said we have addressed this issue on and off for several years and plan to have information to the Board at the August meeting to fully vent this issue and make you aware of the legal standing, the court history, and we will invite MACO to the meeting just so people can understand. There are some counties that have been very compliant in terms of paying for the easement, some counties have balked at it, and some counties have more state lands than others. This has been an issue for MACO for years. We will put together a good briefing paper for the Board and try to give the history and some options.

Mr. Johnson said it would make sense that we not vote on those historic rights-of-ways until we've had that presentation.

Ms. McCulloch asked if there was anything that would be held up or a reason that the Board couldn't segregate those if it wanted to?

Mr. Schultz said in many cases these historic applications have come in six months ago, it takes us a while to process them. Many times these counties are waiting to get these perfected. In some instances people that are selling private land that do have some county road that crosses state land they have asked the county to perfect access because they cannot sell the land if it has some cloud on the access to the property. Knowing that in this particular instance these counties have come forward and have not opposed this, I would suggest approving these and on the next set we can have the discussion and next month we'll bring them forward. In most cases, these are not ones the counties just brought to us, they have been out there for some time. These have been the proactive counties, the ones before the Board today.

Mr. Johnson said he still believes the Board should have the information in hand before it votes.

Ms. McCulloch asked Mr. Johnson if he wanted to amend the motion on the floor or did he just want to vote no?

Mr. Morrison said let's just vote on the motion.

A vote was taken on the motion on the floor. Motion carried with a two to one vote. Mr. Johnson dissenting.

Mr. Schultz said Tommy Butler, Legal Counsel for DNRC, said if there are only three Board members present, there has to be three votes for a quorum. That last vote failed.

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Mr. Johnson moved that the Board approve all of the rights-of-way requests with the exception of the historic rights-of-way requests which impact existing county roads in Fallon and Prairie Counties. Those to be excluded are: from Prairie County, applications #13513, 13514, 13515, and 13516; from Fallon County, applications #13129, 13130, 13428, 13429, 13430, and 13431. Seconded by Mr. Morrison. Motion carried unanimously.

Mr. Morrison said the remaining rights-of-way applications will come back to the Board next month with additional information, is that correct?

Ms. Sexton said yes. We will also look into whether the Board with three sitting members constitutes a quorum. According to §77-1-201, MCA, three members of the Board constitutes a quorum for transaction of business. I would think that the Board is a quorum, and it votes, and depending upon how the vote comes out, you do not have to be unanimous. I will get an opinion on that it needs to be clarified.

Mr. Morrison said not that the substance of this is controversial, but the procedure – I don't like what's happening here procedurally. May we have an explanation from Mr. Butler about what statutory provision he is referring to that suggests that the vote itself has to be a quorum as opposed to a quorum for conducting business and decisions by the majority?

Tommy Butler, DNRC Legal Counsel, said it is my understanding that all Land Board agenda items require a majority of the Land Board to pass. And that majority would be three out of five members. It is true that under the statutes, a quorum of the Board just to meet to transact business is a minimum of three. But in any event it is my understanding that it requires a three-member vote in favor of any agenda item. We'd be happy to conduct further research on that for the Board.

Ms. McCulloch said thanks, I think we do need to know this for the next Board meeting. I am not sure we've had only a quorum of three since I've been here.

Mr. Morrison said I'd like to suggest that Secretary Johnson's motion we just voted on be sustaining regardless of what these rules are. Let's straighten out the rules so that we know in the event we face this again. We're going to review the rest of the rights-of-way applications next month anyway.

Ms. McCulloch said the motion that Secretary Johnson just made and passed on a vote of 3-0 stands for the Land Board.

705-12 APPROVAL TO CHANGE MEETING AGENDA FORMAT

Ms. Sexton said this is a suggestion we bring to you to have all of the items listed for Land Board, not just the agenda itself, but all the materials and documentation, be available on the web. At this point in time, we note at the bottom of our agenda page that folks can contact the office and a copy of any particular agenda item can be sent. The agenda is on the web, but all of the items are not on the web. The only documents where there might be difficulty is with the maps and having them to some sort of scale. The intent here would be that all of the background information for all agenda items would be available on the web. Ms. Sexton said she put this as an action item because she would like to have the Board's approval to move forward with this.

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Ms. McCulloch said I think this is a great idea. I also want to go back, I had a question on the PEIS because Ms. Hedges mentioned she didn't have the latest version. Would someone make sure she gets the latest version of that before we leave here today?

Ms. Sexton said that should be on the web by tomorrow.

Motion was made by Mr. Johnson to approve the new agenda format. Seconded by Mr. Morrison.
Motion carried unanimously.

705-14 TAYLOR TIMBER SALE

This sale is located in Section 16 in Lincoln County. The estimated volume is 51,936 tons or 8,670 MBF, with an estimated value of \$1.225 million. In addition to the estimated stumpage value a Forest Improvement Fee of \$3.26/ton will be charged. The sale is on 587 acres, and the purpose of the sale is for regeneration, thinning, and group selection cutting which would promote forest stand conditions and species composition. Access to the sale is across existing roads. No new road will be built. Approximately 3.6 miles of road will be reconstructed and it will become part of a trail system. Public involvement was solicited through legal notices, letters to adjacent landowners and interested parties. The issues of concern were maintaining healthy, vigorous forests and protecting threatened, endangered, or rare species. There are no old growth stands in this proposed project. Mitigation measures would maintain forests by opening up the stand to reflect historical conditions and all ponderosa pine trees would be retained. Insect attacked trees would be removed. Flammulated owl habitat initially may slightly decrease due to snag loss but over time would improve. Efforts would be made to preserve older snags for nesting. Ms. Sexton requested approval of this timber sale.

Motion was made by Mr. Johnson to approve the Taylor Timber Sale. Seconded by Mr. Morrison.
Motion carried unanimously.

INFORMATION ITEMS

705-13 OIL AND GAS ROYALTY RATE REVIEW

Ms. Sexton said this was discussed at a previous meeting, the potential for increasing the royalty amount which is currently 12.5% and 13% for gas and oil respectively, and the rates required by the land departments of North Dakota and Wyoming. We are looking to increase this rate to 16.67% which would be 1/6. Mr. Mason has done an extensive analysis on this and found we can procedurally implement an increase in the royalty rates through adoption of a new Royalty Rate Form at the August 15th meeting. We recommend incorporation of this rate per notice, we'd have to notice this and include it on the leases auctioned at the next oil and gas lease sale in September. With Board approval, it could be implemented in September. The department would commence with rulemaking concurrent with the Board's decision.

Mr. Mason said I did provide a copy of this to the Montana Petroleum Association for distribution to all of its members. Should the Board choose to direct the department to continue looking at this part of that would be going back out to them from the department and seeking comment which would come back to you and I would expect you would see them in August to provide their take on this. As Director Sexton

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said, we are looking at this and presenting it to the Board because the royalty rate is a key component to the fair market value aspect of an oil and gas lease. It is key because it represents the price the state receives for the oil and gas that is removed from our property, it is really the transfer price. The royalty rates are established by the Board and the current rate is 12.5% - 13%. The report you have summarized the information we've gathered relative to that consideration for an appropriate royalty rate, it provides some options for the Board to consider, and it provides a recommendation from the department based on the information it looked at. But we present it as an informational item this month because it is important for the Board to digest this and also for industry to have time to provide comments because, obviously, they are the stakeholders in this discussion. They are directly affected by this action. Briefly, I want to provide some comments on what is contained in the review.

First, what is a royalty? It is percentage of value; the way we implement it. There are other types of royalties that are just a dollars-per-ton but this is a percentage value. It is done that way because it automatically adjusts for changes in prices and volumes. Out of the portion the operator gets he would pay taxes, operating costs, reclamation costs, and he would fund his capital investment into other exploration to replenish oil and gas, as it is a depletable resource. For a company to have an ongoing business plan they need to explore and find more gas and oil to produce. To look at that and see whether that price is proper, we have sources of data we can look at to see whether that price is the right number to get for that gross value. One is compared to market data of other states – Wyoming and North Dakota. Montana produces out of the same geologic provinces that those states do. Williston Basin comes over from North Dakota into Montana and the Powder River Basin comes up from Wyoming. To a large part we have very similar types of production, similar types of operations, and similar types of exploration. Those states now have a 1/6 royalty rates as their default rate. Under certain circumstances they do have provisions for a lower royalty rate, 1/8 which is where we currently are. North Dakota implements that by reviewing whether there is any production within a three mile radius, if it is outside that radius it gets 1/8, if it is inside it gets 1/6. Wyoming offers all its leases at 1/6. It does have an opening that if nobody bids on the tract, they will offer it at the next sale at 1/8. As you know, our lease sales are set up so we have applicants for them and we require applicants to take the lease if no one bids against them. Wyoming is somewhat different in that regard. The key weakness to both of those is that they provide a loophole for somebody not to take the lease at 1/6 royalty even if they are willing to do so. The department's recommendation is 1/6 across the board. You'll notice that Wyoming issues the great majority at 1/6. North Dakota is somewhat less than half of the 1/6 but they don't offer at the higher rate. Federal is at 12.5% but they do not have the same obligation the state does for trust lands, they don't have to have what is considered a fair market rate for their lands. Tribal lands, in the old days, were primarily administered by the BLM and BIA and they typically went out at 1/8 royalty like the BLM lands. More recently we've seen the tribes take a more proactive role; and you're seeing examples of royalty rates going out in their lease packages at 1/6. Private lands are the hardest to get information on because they are not publicly available in a large statistical format. We do have a few examples given and they do support the fact that leases are being negotiated by private mineral owners at higher than 1/8.

The other source of data available to us is overrides. Overrides are additional royalties that are placed on leases such as ours. For example, if I've taken a lease from the State of Montana and I have a 12.5% royalty I can choose to assign this lease to another party. Part of my compensation could be that I want to reserve a piece of that revenue-wise so I will say I'll transfer this to you but I want a 3% override, which means if you find anything I get 3% of the gross. In that case, the state gets 12.5%, I get 3% on top of that. It is an additional piece of the gross that is carved out that the operator does not get to fund his operation. The interesting thing about overrides is if they are created they are transactions between buyer and seller within industry, indicating that they are willing to take that lease with more than 1/8 carved out

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of it. So when you look at the total royalty burden that is attached to leases, both mineral owner royalty and overrides, you get an indication of the total non-cost bearing share that can be taken away from the gross and still be an economically viable contract.

As Ms. Sexton said what we're seeing in reviewing the override data we have, and we can obtain that data in two ways, one is through lease assignments where those will be part of the assignment document, we're seeing a lot of them now that are 7%. That means the total royalty share is close to 20%. Of course they can adjust over time somewhat because prices do go up and down, but we've done reviews on assignments we've had, and seen that we're having a lot of them go much higher than in the past. We reviewed nearly 300 lease assignments and the average was 19.72% carved out. We can also see override data through the communitization agreements. Part of the background information there shows what overrides are attached to leases. Those are not just the state's leases, also federal and private. We see that information on all mineral owners. We did a review of that recently and one in 1993 and both of them came within the range of 18% for total royalty burden. That would be 6%+ for overrides. Another example is, I pulled some economics at random from the Board of Oil and Gas records and I find that in the economics they prepare operators typically are showing they are assuming a 20% royalty burden on their data. All of this together provides multiple source of indications that oil and gas operations in general are a commodity that is marketable with something in the range of 15% - 20% commonly, whereas in the old days 1/8 was the industry norm.

Again, we've put all this information together for the Board's review and consideration. We're asking you to consider a threshold issue – do you want to pursue this? If you do, we've got a recommendation for us to consider a 1/6 royalty rate flat, which is equivalent to what the neighboring states do. It is important to note that this will not affect leases that are already issued because those are contracts and we cannot adjust leases that are already out the door. Assuming you want to ponder this at the August Board meeting, the process for implementation is we would use the existing administrative rule which does provide the ability for the Board to advertise leases at higher than the base rate of 12.5% and 13% through notice. If you were to direct us to do that at the August Board meeting, we could do that because that is the day when we finish our final notices and mail them out. That is the time we'd have to make that call. If we did that, we would have to revise the rule so the default would be wherever the Board chose to set it. Plan B would be to not change the royalty rate until we finish rulemaking but the department feels the rule is clearly open to the Board setting higher royalty rates and that would be our recommendation. The next lease sale or two would go at whatever rate you chose to implement. Option three would be to leave things the way they are. We're asking you to take a look at this, perhaps direct me to go out to industry and seek public comment to bring back to you at the August Land Board. We'd ask for your consideration at that time on whether to make the change.

Ms. McCulloch said if we increase the royalty rate from 1/8 to 1/6 we will be at about the same percentage as the surrounding states would make for their school trust lands?

Mr. Mason said that's correct. North Dakota and Wyoming would be the same except for the loophole they have for reduction in certain instances. Colorado is at 1/8 and they say they have no plans at this time to adjust it. Utah is still at 1/8. I would argue the ones that are most appropriate for comparison are the ones that are adjacent to us in the same geologic basins.

Ms. McCulloch said if this comes before the Board in August and it passes, I am unclear as to the rulemaking. The rule allows for higher than the current rate, how much of the rulemaking process do we still go through?

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Mr. Mason said you are correct. The rule, ARM 36.25.210 provides that the royalty shall be at the following rates, which is 12.5% and 13% currently, unless in regard to a particular lease the department advertises its lease on its lease sale notices that the royalty rate will be a higher rate. So the Board has the authority to advertise on any particular lease, which in this case would be all of them in the sale. With rulemaking we'd be changing those default values from where they are now to what you decide it should be. You would still have the option to set them higher or lower at that point for any particular tract. Right now you can't set them lower because statute sets a floor of 12.5%.

Mr. Morrison said do you anticipate that raising the royalty rate to 1/6 would cause a noticeable reduction in drilling activity?

Mr. Mason said I do not.

Mr. Johnson said I think it is essential that the department be proactive in seeking input from the industry between now and the August meeting.

Ms. Sexton said we will place this item on the August agenda as an action item.

Ms. McCulloch said do we feel placing it on the August agenda is enough time for the industry to be able to respond? I don't want the issue raised "we didn't have enough time".

Mr. Mason said I don't doubt that that issue will be raised and you may be asked to defer. I think it is an adequate amount of time. They are dealing with that rate and total royalty right now. They will have to accept a bit less in overrides and they'll have the same total royalty burden they have now. It will be the Board's call at that point. I already have it out there and will follow up with direct contact and make sure everyone is aware of it, when the Board meeting is, and we'll see what we get.

Ms. Sexton said I would add that this information item has been pre-noticed so there will be a full month of consideration.

PUBLIC COMMENT PERIOD

Gail Abercrombie, Executive Director, Montana Petroleum Association, said regarding the royalty rate changes, we did receive these from Mr. Mason last week and I have distributed them to the members. We will see what the responses are. We do not know at this time what they will be, but I will encourage them to contact you. I have an issue with the idea of making an administrative rule change for the September oil and gas lease sale in that the rules state, "that the following rates unless in regard to a particular lease..." Mr. Mason stated he considered "a particular lease" the whole lease sale. But in my reading a particular lease would be a certain lease that had a very high demand area, say in Richland County, and you would change that rate to a higher rate and for all the other leases they would stay at 12.5% - 13%. I do have a problem with administratively changing the whole lease sale in September and increasing that. If the Board chooses to go forward after reviewing all the evidence I would recommend it go through a full rulemaking process with public disclosure and postings and the public notice. The reason is, there are a lot of folks out there that are not members of my association and are not members of the Northern Montana Oil and Gas Association. The public notice that goes to the newspapers is very valuable to

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everyone. Please be aware that I will be getting this out. Please read carefully the comments submitted to make sure we're going down the right path.

Ms. McCulloch said Mr. Butler and Mr. Mason can you make sure you look into that so you can address it at the next meeting?

Ms. Sexton said the check off list for purchase was reviewed by you and we will be sending a letter to all realtors and interested parties who may nominate parcels. We will also be in the process of putting together a press release regarding the land banking/acquisition process.

Motion was made to adjourn by Mr. Morrison. Seconded by Mr. Johnson.